No. 85-1877

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

October Term, 1985

AZL RESOURCES, INC.,

Petitioner,

v.

MARGARET HALL FOUNDATION, INC., *et al.*,

Respondents.

PETITIONER'S REPLY MEMORANDUM

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Petitioner, AZL Resources, Inc. ("AZL"), respectfully submits this Reply Brief to address respondents' contention that this Court, having declined several years earlier to review cases involving the applicability of common law agency principles to the securities laws, should decline review here. This case is significantly different from the prior cases. Review is particularly appropriate for three reasons.

First, this case, unlike the cases cited by respondents in which the Court declined review, involves the application of apparent authority, rather than respondeat superior. The tension between common law agency principles, and principles of liability under section 20(a) of the Securities Exchange Act, 15 U.S.C. § 78t(a), is particularly exacerbated where no authorized corporate act was committed and, therefore, where there could not have been scienter by the corporation. In the absence of scienter, no legally sufficient claim for relief could be stated.

Respondents argue that the agent's scienter should be imputed to the principal, for there was "apparent authority." But this begs the question. AZL does not dispute that corporations act only through their agents. Nor does AZL dispute that where an agent acts for the corporation, his scienter is imputed to the corporation. But, where, as here, the agent acts for himself, with no intent to further a corporate purpose, there is no logical basis for imputing the agent's scienter to the corporation. It may be that under the common law a principal is liable for the fraud of his agent committed with apparent authority. This does not mean, however, that statutory liability under section 10b-5 may be found against the corporation absent a showing that there was a corporate intent to defraud, or that the corporation benefitted from the fraud. This is the teaching of *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), and the meaning of section 20(a).

Second, in the five years since the Court last declined to consider the effect of section 20(a) on common law agency principles, the lower courts have shown a confusion that has made them unable to apply a coherent theory of vicarious liability under the securities laws. Compare, for example, the district court opinions in *Frankel* v. *Wyllie & Thornhill, Inc.*, 537 F. Supp. 730 (W.D. Va. 1981) (common law principles applicable in Fourth Circuit) with *Haynes* v. *Anderson & Strudwick, Inc.*, 508 F. Supp. 1303 (E.D. Va. 1982) (common law principles not applicable in Fourth Circuit).[1]

1. Even where a consistent result is reached, the theoretical underpinnings of such liability become confused. Thus, the district court in this case apparently believed that it was holding AZL "directly" liable for the acts of its agent, as opposed to vicariously liable. App. D at 38a. The First Circuit made no such distinction, finding apparent authority to be another type of vicarious liability. App. A at 8a.

Third, since common law agency issues were last presented to this Court, this Court decided *American Society of Mechanical Engineers* v. *Hydrolevel Corp.*, 456 U.S. 556 (1982), applying principles of apparent authority to the Sherman Act. The First Circuit applied *Hydrolevel* to the securities laws, without taking into account section 20(a) and the teachings of *Ernst & Ernst* v. *Hochfelder*, 425 U.S. at 200, that Congress in the securities laws, as distinguished from the antitrust laws, fashioned standards of fault on a particularized basis.

We submit that the Court should now decide the issue of the applicability of common law apparent authority principles to the securities laws and provide guidance for the lower courts. The issue was important in the antitrust context. It is equally important in the securities context.

Respectfully submitted,

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